Internal Revenue Service

memorandum

CC:TL:TS/P
TJKANE/lmr

date: SEP 30 1991

to: District Counsel, Denver CC:DEN
Attn: David P. Monson

from: Assistant Chief Counsel (Tax Litigation)

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subject: [redacted] - TEFRA Statute of Limitations
TL-N-8745-91
CC:TL:TS/P Kane Wilson

This is in reply to your request for tax litigation advice dated July 11, 1991.

ISSUES

1. Whether the Internal Revenue Service can issue a statutory notice of deficiency for the tax year [redacted] for the additional income that [redacted] received from [redacted], a TEFRA partnership, in light of the fact that no individual income tax return has been filed by [redacted] for [redacted].

2. Whether an assessment made on [redacted], based on the filing of [redacted]'s "amended" income tax return for tax year [redacted], constitutes a valid and timely assessment of the TEFRA flow through adjustments made to [redacted]'s partnership return.1/

1/ Although your request for tax litigation advice states that the assessment was made on [redacted] the transcript of account for the [redacted] tax year indicates that the assessment was made on [redacted]. An assessment made on [redacted], would have violated the automatic stay applicable to the bankruptcy proceeding because [redacted] was not discharged from these proceedings until [redacted] (see discussion in FACTS).

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CONCLUSIONS

1. Given your unique facts and circumstances, and specifically the fact that no individual income tax return has been filed by [redacted] for [redacted], the Service can properly issue a statutory notice of deficiency to [redacted] for [redacted] that would include adjustments relating not only to the additional income that [redacted] received from [redacted], but all of the items of taxable income, deductions, credits, etc., relating to [redacted] as well as any other adjustment that would impact on [redacted]s federal income tax liability for [redacted].

2. We agree with your conclusion that on [redacted] the Service was able to properly assess an income liability for [redacted] as a result of [redacted]'s filing an amended return for that year.2/ However, we believe that the procedure followed by the Ogden Service Center in making the assessment was improper. As a result, the Ogden Service Center assessed more tax than was legally permissible. Therefore, a partial abatement of the assessment made on [redacted] should be made, reducing the assessment to the amount of admitted tax liability shown on the amended return, i.e., $[redacted].

FACTS

[redacted] was an investor in [redacted] during the years [redacted] and [redacted]. On [redacted], a Notice of Beginning of Administrative Procedure ("NBAP") was mailed to [redacted] with respect to [redacted] for [redacted]. On [redacted], a NBAP was mailed to [redacted] with respect to [redacted] for [redacted]. On [redacted] [redacted] filed a petition in bankruptcy court pursuant to Chapter 7 of the Bankruptcy Code. He received a discharge on [redacted]. On [redacted] Notices of Final Partnership Administrative Adjustment ("FPAAs") were mailed to [redacted] for the years [redacted] and [redacted]. No petition for readjustment was filed, and

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2/ An assessment made on [redacted] would not conflict with the automatic stay. Our analysis will reflect an assessment date of [redacted], as that is the date on the permanent records of the Service.

the taxes for the years [redacted] and [redacted] calculated on the bases of the TEFRA adjustments were assessed against [redacted] on [redacted] through computational adjustment. Of course, because [redacted] had filed for bankruptcy prior to the expiration of time for filing a petition on the FPAA, his [redacted] partnership items for [redacted] and [redacted] had converted to nonpartnership items and he was no longer a party to the TEFRA proceedings. I.R.C. § 6226 and Temp. Treas. Reg. § 301.6231(c)-1T(a). Consequently, the [redacted] assessment was improper.

No federal income tax return has been filed by [redacted] for [redacted] filed an "amended" income tax return for [redacted] on [redacted]. There is no record that [redacted] ever filed an original income tax return for [redacted]. On the amended [redacted] income tax return, [redacted] included $[redacted] of additional income that resulted from the [redacted] examination. This income represented [redacted]'s distributive share of the profits of the partnership. The deductions claimed on the amended income tax return were disregarded by the Ogden Service Center, the tax was recomputed, and $[redacted] in income tax was assessed on [redacted]. Only $[redacted] of income tax liability was reported by [redacted] on his amended [redacted] income tax return. The improper assessment based on the computational adjustment made on [redacted] for [redacted] in the amount of $[redacted] relates to the same amount of income that was reported by the [redacted] on his [redacted] amended income tax return filed on [redacted].

Issue 1

The partnership audit and litigation provisions of I.R.C. §§ 6221-6233 (TEFRA) generally apply to partnership taxable years beginning after September 3, 1982. Pub. L. No. 97-248, § 407(a)(1), 98 Stat. 324, 670.

Prior to the enactment of TEFRA, the period of limitations for assessment of partnership items was the same as for nonpartnership items. Section 6501(a) provides:

> **General Rule.**-Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within three years after the return was filed (whether or not the return was filed on or after the date prescribed) . . . and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period. (emphasis supplied)

Section 6229(a) provides:

> **General Rule.**-Except as otherwise provided in this section, the period for assessing any tax imposed by subtitle A with respect to any person which is attributable to any partnership item (or affected item) for a partnership taxable year shall not expire before the date which is 3 years after the later of-
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> (1) The date on which the partnership return for such taxable year was filed, or
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> (2) the last day for filing such return for such year (determined without regard to extensions). (emphasis supplied)

I.R.C. § 6229(f) provides:

> **Items Becoming Nonpartnership Items.**-If, before the expiration of the period otherwise provided in this section for assessing any tax imposed by subtitle A with respect to the partnership items of a partner for the partnership taxable year, such items become nonpartnership items by reason of 1 or more of the events described in subsection (b) of section 6231, the period for assessing any tax imposed by subtitle A which is attributable to such items (or any item affected by such items) shall not expire before the date which is 1 year after the date on which the items become nonpartnership items. The period described in the preceding sentence (including any extension period under this sentence) may be extended with respect to any partner by agreement entered into by the Secretary and such partner. (emphasis supplied)

There are two interpretations of the general rules found at section 6229. One is that section 6229 merely extends the period of limitations for all items, including partnership items, set out by section 6501(a) (the "statute extension interpretation"). The other position is that section 6229 sets out a separate period of limitations for partnership items, and section 6501 refers only to nonpartnership items (the "separate period interpretation").

The uncertainty on this issue stems, in part, from differences in the language of the two "general rules" found at sections 6501(a) and 6229. Section 6501(a) states that any tax "shall be assessed" within three years of the filing of an individual return. Sections 6229(a) and (b), on the other hand, state that the period of limitations "shall not expire before ...".

A. Separate Statute Approach

The primary argument for a separate statute approach is that section 6229(b)(2) implies that section 6229 is separate from section 6501 rather than a mere extension of section 6501. Section 6229(b)(2) states:

> **Coordination with section 6501(c)(4).**-Any agreement under section 6501(c)(4) shall apply with respect to the period described in subsection (a) only if the agreement expressly provides that such agreement applies to tax attributable to partnership items.

If section 6229 merely extended section 6501, an extension of section 6501 would automatically extend the period of limitations for partnership items, and a specific reference to partnership items would not be necessary. Thus, the fact that section 6229(b)(2) requires an express reference to partnership items for an extension under section 6501(c)(4) to apply to partnership items may indicate that sections 6229 and 6501 provide separate periods of limitations.

Another argument in favor of the separate period interpretation is that it discourages different periods of limitations for partners within the same partnership. The basic premise of the TEFRA audit procedures is to provide a unified proceeding for all partners and a single period of limitations advances that goal. On the other hand, Congress specifically allowed for differing periods of limitations in allowing individual partners to extend the section 6229 period(s) with respect to themselves. See I.R.C. § 6229(b)(1)(A); see also I.R.C. § 6229(f) (last sentence) and I.R.C. § 6226(c) and (d)(1)(B) (partner ceases to be a party to TEFRA proceeding after period for assessing his partnership items expires).

Still another argument in support of the separate statute interpretation is found in section 6503(a), which provides for suspension of the period of limitations when a statutory notice of deficiency is mailed. Section 6503(a) makes specific reference to the "period of limitations provided in section ...

6229...". 3/ Here again, the reference to § 6229 serves no purpose if section 6229 merely extends section 6501. Section 6503(a) suspends the period under section 6229(a) for assessing tax attributable to affected items following a partnership proceeding. It also operates to suspend the period under section 6229(f) for partnership and affected items which have converted to nonpartnership items when a notice of deficiency under sections 6230(a)(2)(A) and 6212(a) is sent with respect to such items. If section 6229 merely operates to extend section 6501, then an affected item notice of deficiency would extend section 6501, and this amendment would not have been necessary.

B. Statute Extension Approach

The statute extension approach relies on the "shall not expire before" language of I.R.C. §§ 6229(a) and (f) to conclude that section 6229 merely extends the otherwise controlling period of limitations under section 6501.

The rationale supporting this approach is that had Congress intended section 6229 to supplant section 6501 entirely, Congress would have used language that paralleled section 6501, i.e., "tax . . . shall be assessed within 3 years [or 1 year] after the return was filed . . .". Instead, Congress provided that the period of limitations "shall not expire before . . .". This

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3/ Section 6503(a) provides:

> **(a) Issuance of Statutory Notice of Deficiency.-**
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> **(1) General Rule.-**The running of the period of limitations provided in section 6501 or 6502 (or section 6229, but only with respect to a deficiency described in section 6230(a)(2)(A)) on the making of assessments or the collection by levy or a proceeding in court, in respect of any deficiency as defined in section 6211 (relating to income, estate, gift and certain excise taxes), shall (after the mailing of a notice under section 6212(a)) be suspended . . . for the period during which the Secretary is prohibited from making the assessment or from collecting by levy or a proceeding in court (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final), and for 60 days thereafter. (emphasis supplied)

language implies that section 6229 was merely intended to keep the period of limitations under section 6501 open when it would otherwise expire earlier. This interpretation is supported by reference to identical "shall not expire before" language contained in I.R.C. § 6501(c)(7), which provides for a 60-day extension of the otherwise applicable period of limitations when an amended return is filed just prior to the expiration of such period.

In discussions with congressional staff members on the various tax-writing committees, most recently in connection with the recently introduced technical corrections to the TEFRA provisions, we were informed by the staff members that there is no question in their mind that the statute extension approach was intended, and that they believe that the plain language of the I.R.C. § 6229 adequately supports this approach. Consequently, they refused recommended language to clarify the statute.

Arguably, Congress anticipated a normal three year period for TEFRA and non-TEFRA cases (I.R.C. §§ 6229(a) and 6501(a)) and provided that additional one year period of section 6229(f) to give the Service at least one additional year to assess after conversion of items from partnership to nonpartnership status. Events may occur which will operate to convert partnership items well before the section 6501 period would expire. A separate statute interpretation would, in many cases, make it almost impossible to assess converted items within the brief period provided under section 6229(f).

For instance, a bankruptcy filing may significantly shorten the time within which to assess tax attributable to partnership items. A bankruptcy filing by a partner converts the partner's partnership items to nonpartnership items and triggers the one year period for assessment under section 6229(f). Temp. Treas. Reg. § 301.6231(c)-7T(a). If a partner filed for bankruptcy on January 2, 1990, and filed his 1989 individual return under a sixth month extention on October 15, 1990, the Service would have only two and one-half months to assess the tax attributable to the converted items. Thus, cases involving bankruptcy, nonfilersand criminal cases, where the period of limitations would be open under section 6501(c)(1) (pertaining to false and fraudulent returns), present facts which we believe are favorable for making a statute extension argument.

After discussing this issue with the Chief Counsel and Deputy Chief Counsel, we feel that it is appropriate to authorize the issuance of a statutory notice of deficiency under the statute extension approach in select test cases that meet certain criteria. Those criteria are:

(1) Potential test cases that are still subject to the jurisdiction of a bankruptcy court,

i.e., there has been no discharge, will not be selected as test cases.

(2) The proposed deficiency (or deficiencies) exceed $10,000 for each year in issue. This will prevent the test case from being docketed as an "S" case and, in addition, provides enough potential dollar impact to act as a clear incentive to file a petition in the Tax Court.

(3) In cases that have been through bankruptcy proceedings and have been discharged from those proceedings, the bankruptcy proceedings and the status of the federal taxes in those proceedings must be reviewed in order to ascertain whether any adverse consequences could be expected as a result of the bankruptcy. As an example, in a "no asset" case that is brought to the attention of the Service, the fact that a taxpayer is destitute with little hope of financial recovery in the forseeable future diminishes the possibility that the taxpayer would challenge a subsequently issued statutory notice of deficiency by filing a petition in the Tax Court.

(4) How the other partners in the affected partnership(s) have been or are expected to be treated must be explored in order to ensure that a taxpayer cannot raise an issue concerning disparate treatment.

(5) Any case selected as a test case must not be imbued with facts that could provide the Tax Court with an opportunity to despense "equitable justice" in favor of the taxpayer, e.g., a "widows and orphans" or "mope" defense.

After reviewing the facts of your case set forth in your request for tax litigation advice, as supplemented by your telephone conversations with Tom Kane of this office, we believe that all of our criteria for test case selection with respect to [redacted]'s [redacted] tax year have been met. We therefore authorize the issuance of a statutory notice of deficiency for [redacted] under the statute extension approach. Please keep us advised as to any and all developments that take place subsequent to the issuance of the statutory notice of deficiency.

Issue 2

Initially, we note that we agree with your conclusion that the amended income tax return for [redacted] should be treated as an original income tax return for such year. Because the assessment made with respect to that return was made after [redacted] was discharged from the bankruptcy proceedings, the assessment was legally made. However, we disagree with the amount of tax that was assessed, i.e., $[redacted] and recommend that the assessment be partially abated to reflect only the tax liability that was undisputed by [redacted] as reflected on his amended imcome tax return, i.e., $[redacted].

In processing [redacted]'s amended income tax return for [redacted] the Ogden Service Center accepted the total income he reported, but disallowed all deductions and credits that he claimed on the return.4/ Thus, the amount of tax actually assessed was well in excess of the amount of tax liability that admittedly existed. We fail to see any basis for the Ogden Service Center's procedure.5/ As a general matter, absent an admitted tax liability on an acceptable federal income tax return, the Service's ability to assess an income tax without having to go through the deficiency procedures is limited to assessments arising out of mathematical or clerical errors. I.R.C. § 6213(b)(1). The definition of a mathematical or clerical error is found at I.R.C. § 6213(g), and typically encompasses items such as true math errors appearing on the face of the return, i.e., 2 + 2 = 5. See, e.g., Adler v. Commissioner, 85 T.C. 535, 542 (1985). Blanketly disregarding the deductions and credits claimed on the face of the return constitutes substantive adjustments to the return that would result in a deficiency in income tax, and not mathematical or clerical errors, such that no assessment can be made with respect to any additional tax that would result from the adjustments without resort to the deficiency procedures.

The excessive portion of the [redacted] assessment, in the amount of $[redacted] should be abated pursuant to the provisions of I.R.C. § 6401(a). In accord with our analysis and conclusion as to Issue 1, above, although the normal period of limitations under I.R.C. § 6501 with respect to [redacted] is still

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4/ A similar procedure was followed with respect to his [redacted] tax return, which is not at issue here, but which was filed at the same time the [redacted] tax return was filed.

5/ There is a difference of $[redacted] on the transcripts between the adjusted gross income and the taxable income for both [redacted] and [redacted]. Although this number could represent the exemption amount, the exemption amounts for [redacted] and [redacted] were $[redacted] and $[redacted], respectively.

open, it does not appear that our criteria for test cases can be met with respect to [redacted]. Therefore, you are not authorized to issue a statutory notice of deficiency with respect to that year.

If you have any questions concerning these issues, please do not hesitate to contact Thomas J. Kane at FTS 343-0032 at your convenience.

MARLENE GROSS

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